Energy Pricing Offers 101

What to Look for When Gathering Electricity and Natural Gas Pricing Offers
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Introduction

At first glance, when you begin shopping for competitive pricing offers from energy suppliers, it may seem overwhelming. Not every supplier may provide you with the same information or even explain how their pricing quote was derived, making it hard for you to quickly identify the best offer for your business. This guide will highlight some of the important terms and components that comprise most electricity and natural gas pricing offers so that you can better understand what items may require clarification and which offers make the most sense for your business.

Please note: pricing is typically presented along with/as part of a complete contract, with terms and conditions that can be negotiated. This guide will only touch on the language/components that comprise your quoted price—and not the complete terms of an energy contract. Please be sure to include your legal counsel in the review and interpretation of the terms and conditions that may come along with the pricing quotes you receive, so that you may receive guidance on the best terms and conditions for your business. In addition, if you previously took electricity or natural gas service from your local utility, you may not have had to sign a contract. All competitive energy suppliers require signed contracts to serve business customers therefore this is an important element of working with a supplier that you will need to consider.
Energy Pricing 101

Price of energy supply: Quoted in cents or dollars per unit.

Amount to be supplied (i.e. “usage”): how much energy you’re expected to use. This is generally derived from historical consumption and future consumption estimates.

Duration of the service (i.e. “term” with start and end dates): Indicates the start/end date of the quoted price. The quoted price associated with any particular term/timeframe will vary.

Anatomy of a Pricing Offer

When you receive a price quote for electricity or natural gas from an energy supplier, generally there are three core items that are up front and center:

- **Price of energy supply:** Quoted in cents or dollars per unit.
- **Amount to be supplied (i.e. “usage”):** How much energy you’re expected to use. This is generally derived from historical consumption and future consumption estimates.
- **Duration of the service (i.e. “term” with start and end dates):** Indicates the start/end date of the quoted price. The quoted price associated with any particular term/timeframe will vary.

While pricing offers are similar for power and gas, the two fuels are measured and priced in different units so we will talk about each commodity separately.

Electricity Pricing Offers: Cost Components

The price quote or “offer” will be quoted in cents per kilowatt-hour (kWh) or dollars per megawatt-hour (MWh). In order to make an accurate comparison between the offers you receive, you need to know for sure (either by reading through the pricing offer or by asking the supplier to clarify) what is included in that price quote. To be specific, the following items are the common components that comprise an electricity rate:

- **Energy:** The cost of the commodity itself. This is usually calculated by a supplier as the cost to purchase the amount of power you need in the wholesale market for the specific length of time [term] you are seeking.
- **Capacity:** Capacity is a requirement of the electric system operators in several electricity markets. These charges help guarantee that there will be sufficient generation to meet the maximum energy requirements of the market at all times.
- **Ancillary services:** Charges for the services required to support and maintain reliable operation of the electric grid.
- **Losses:** Charges that cover the electricity losses that occur between the point of generation and delivery to your business.
Electricity Pricing Offers: Cost Components (con’t)

Transmission: The charges associated with the cost to move power from the generator to your local distribution company. This can either be billed by your supplier or by your local utility, depending on your state and the type of product you’re being priced for.

Renewable Portfolio Standards (RPS): If your state mandates participation in a renewable energy program, your supplier is required to procure a portion of your power from renewable sources. RPS obligations are common in most states.

Why is this information important?
By understanding the pricing components that go into calculating your price quote for electricity supply, you are prepared to ask questions about what is/is not included in the rate quote, and ultimately positioned to make better decisions about which product/offer/supplier will work best for your business.

Included or Passed Through?
In some cases, the above charges may be included as part of your price quote OR they may be passed through as individual charges. There are different product configurations that suppliers may offer that are more or less inclusive.

If you receive two fixed price offers, and one is for $0.06 per kWh while the other is for $0.085 per kWh, it is important to determine if both offers include the same pricing components and are for the same delivery term.

A “fixed all-inclusive” product should contain all of the above components wrapped into one rate (which would appear as your “price” in such a quote). Typically in this scenario—which provides the maximum amount of price protection from monthly fluctuations in your energy supply charges—the fixed all-inclusive price will contain a premium to cover the cost components that may vary over the duration of your service. This protects a supplier, who must estimate all of these changing cost components, in order to provide you with an all-inclusive price for your desired term.

A “fixed product with varying pass-through charges” could include one or more of the above items wrapped into your fixed rate, and several others passed through separately. It could also mean that your Energy component is fixed and all of the other charges are passed through at cost.

It’s important to clarify this because a fixed rate quote that does not include every single cost component will be lower—since only one or a few components are included in the rate. Sometimes this can be good if there are ways your business may be able to benefit from certain cost components being passed through at cost each month.
How do I know which way to go?
Your sales representative who provides you with your price quote will be able to provide the necessary information to help you determine which product configuration is best for your business—and even present you with price quotes for different scenarios and terms so that you can make an educated comparison on the various product configurations as they apply to your unique usage profile.

Usually businesses with less risk tolerance choose product configurations that wrap most cost components into one fixed rate—even if it means paying a slightly higher price premium to do so.

Businesses that have more tolerance for monthly fluctuations in energy supply charges may opt to fix only their Energy costs and have the other cost components passed through at cost. While the various components can fluctuate monthly, in this scenario, your Energy charges would not. In addition, businesses that are located in regions where regulatory events and market conditions could weigh in (either positively or negatively) on certain pricing components, may have more or less reason to have those components fixed or passed through.

Amount to be Supplied
Another factor weighing in on what your price quote looks like is your usage. Because the supplier quoting you a price may not have been serving you previously, they would be basing their quote in part on your "historical usage," which can be obtained through the local utility or by providing a supplier with a recent invoice from your current supplier/local utility. The pricing offers you receive would then be customized to your business' unique load requirements and would be based on the assumption that your facility will continue to use roughly the same amount of energy going forward.

This is an important factor in a pricing calculation because suppliers want to purchase enough, but not too much or to little, power on your behalf, which helps to keep their costs to serve you in-check—as well as your own costs.

Because your usage is, to an extent, being estimated, if you know that you will have changes at your facility that would cause noticeable increases or decreases in your usage during the term you are being quoted for, now would be the time to discuss that with the supplier quoting you a price. First off, a more accurate usage profile can work to your benefit in terms of pricing—especially if your usage will be decreasing.

An example of this would be a manufacturing facility cutting back on production or hours of operation or an office building downsizing from 10 floors to five. If a supplier knows up-front of changes in your usage profile (either up or down), they may be able to more accurately derive your price quote.
**Why is this important?**

Check with your suppliers on whether or not there are penalties associated with fluctuations in your expected usage—and within what range. Some suppliers may not include “unlimited bandwidth” in their pricing quote, which could mean that you are charged at a higher rate than your quoted price, or assessed monetary penalties, if you need more (or less) power than your price quote was based on during any particular billing cycle.

Suppliers that offer unlimited bandwidth with no penalties often build a premium into their fixed price to cover such fluctuations, since they are locking in your power in the market at the specific quantity that you are estimated to need during the specified timeframe.

Knowing what bandwidth penalties do or don’t exist will assist you in making the right decision about whether or not you need to be concerned with additional charges during your term—or, if paying a premium up front to cover usage fluctuations may be more appropriate.

**Delivery Period**

The timeframe for which you are requesting a price quote will impact your quote. While your bidding documents may clearly outline your desired term, make sure that all of the quotes you receive are for the same term.

For example, a 24-month fixed price contract rate of $0.08 per kWh may actually be a better value than a 12-month contract at $0.07 per kWh, because a longer term may protect you from potential rate increases during the second year of the contract. Your sales representative can help you assess current and future market conditions, as well as the timing of your contract length, to help you determine if a slightly higher rate over a longer time period could be more beneficial than a lower rate over a shorter time period.

The start and end date of your contract can also factor into your decision to consider a longer or shorter delivery period for pricing. If, for instance, your current fixed rate is set to expire during a time of the year when market volatility is common, or unexpected weather-related events cause forward prices for the following year to rise, you may end up receiving a higher price quote for your next delivery period than your current fixed price. In a case like this, locking in for a longer period of time at a particular rate could have proven to be more advantageous.

Every business is unique and each of the three components that factor into your price quote—your total energy price, your usage requirements and the length of the delivery period—will have different importance, depending on your business goals and your energy requirements. Suppliers that truly want your business should be ready and willing to provide you with the information you need to make an informed decision. If they aren’t cooperative, you may be cautious about engaging them for service.
Because natural gas, unlike electricity, is a physical commodity that can be stored, the distribution system is not as complex and there are fewer corresponding charges that comprise the total fixed price quote.

Natural Gas Pricing Offers: Cost Components

The price quote or “offer” will be quoted in either dollars per decatherm (DTh) or therm (Th) or dollars per million British thermal units (MMBtu). To compare, if you’re receiving price quotes in varying units, one decatherm is equal to one million Btus. In order to make an accurate comparison between the offers you receive, you need to know for sure (either by reading through the pricing offer or by asking the supplier to clarify) what is included in that price quote. To be specific, the following items are the common components that comprise a natural gas rate.

**Commodity:** The cost of the natural gas itself. This is usually calculated by a supplier as the cost to purchase the amount of gas you need in the wholesale market. Most natural gas contracts are priced through the New York Mercantile Exchange (NYMEX) index for the specific length of time (term) you are seeking.

**Basis:** The financial basis is the cost difference between two liquid trading points within the interstate pipeline system. Since most natural gas contracts are priced through the NYMEX but the gas is required in a particular region (i.e. where your business is located), your regional basis price must then be added to the NYMEX price.

**Physical Premium:** The cost of converting the “paper” value of the gas contract purchased by a supplier into a “physical” value, to allow the gas to flow at a specific point on the pipeline.

**Transportation:** Transportation costs are paid to the pipeline company and cover the cost of reserving the space inside the pipeline ("pipeline availability") and physically moving the gas through the pipeline.

**Fuel or Losses:** The costs to replace the gas that is used or lost along the pipeline between the citygate (i.e. your local distribution company) and the delivery point (your business).

*Why is this information important?*

By understanding the pricing components that go into calculating your price quote for natural gas supply, you are armed to ask questions about what is/is not included in the rate quote—and ultimately positioned to make better decisions about which product/offer/supplier will work best for your business.
Amount to be Supplied

As with power pricing, another factor weighing in on what your natural gas price looks like is your usage. Suppliers should do their best to base their quote on your “historical usage,” so that the pricing offers you receive are customized to your business’ unique load requirements. This is important because suppliers want to purchase enough—but not too much or too little—natural gas on your behalf, which helps to keep their costs to serve you in-check—as well as your own costs. Otherwise, suppliers may incur additional costs during the time they serve you and some of these may be passed onto you when applicable.

Protecting yourself from usage variations: swing or no swing

Most suppliers will give you the option to have no swing, 10% swing or 100% swing (i.e. “full requirements”) associated with either the fixed or variable natural gas products for which you may be receiving quotes. Swing allows your business to go above or below the amount to be supplied (oftentimes referred to as “contract quantity”), while still being billed or credited for any used/unused volume at your fixed or index price.

Businesses that choose a product with no swing could be billed or credited at a daily market price, which may not be as favorable as the fixed price they are locked in at, or they may be assed monetary penalties for going above or below the estimated agreed-upon amount to be supplied. Typically, if you choose a 100% swing option, also called “full requirements,” you may go above or below your amount to be supplied and still be billed/credited at the contract price for that over/under volume.

Adding swing to a product provides a level of protection for customers who are unsure of their volume requirements or expect that it may change, as well as those who have low risk tolerance for price fluctuations. Typically a premium is built into your fixed price to cover these usage fluctuations and that premium would likely be higher for a full requirements product than for a product with 10% swing.

Delivery Period

The timeframe for which you are requesting a price quote will impact your quote. While your bidding documents may clearly outline your desired term, make sure that all of the quotes you receive are for the same term or delivery period, which should be clearly outlined in the quote.
Soliciting Pricing Offers: Things to Think About

Now that you understand the basics of what goes into a price and why those factors are important, here are a couple of reminders to tape to your computer as you work your way through the energy supply price quoting process:

Checklist:

- Solicit bids from qualified competing suppliers. Like bidding for other products and services, a minimum of three is fairly standard.

- Ensure that you ask the necessary questions to conduct an apples-to-apples comparison of your pricing offers—review what pricing components are included/not included, what additional charges or penalties could be assessed for fluctuations in your “amount to be supplied,” and what delivery period the quotes cover. It’s important to also check any differences in price quotes for different delivery periods, should a more appropriate pricing offer be available for a delivery period that is different than what you were requesting.

- Be prepared to ask for different pricing configurations and delivery periods to further compare your options. And, ask for justification between pricing that you receive if a supplier comes in too high or too low from the others.

- In addition to your pricing offers, make sure that your final decision/bid selection is based on more than just price. You want to make sure that you are engaging a company that is financially stable and capable of meeting your billing and service needs, as well as meeting your price requirements.

About Direct Energy Business

Direct Energy Business is part of the largest retail energy supplier in North America and a champion in serving businesses’ diverse energy needs. Our leadership position, deep expertise and commitment to addressing our customers’ unique energy demands is how we earn the trust of our customers and help to make their businesses better.

With more than 25 years of industry experience, we are dedicated to helping companies make smart energy choices for their business. Contact us today to discuss your energy needs and we’ll help you navigate the opportunities available to your service location(s).

Learn more about Direct Energy Business and other energy strategies for businesses and organizations of all types by visiting business.directenergy.com or call 888.925.9115.